

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Honda Analyst: Colin Stevens Bill Number: AB 2458

Related Bills: _____ Telephone: 845-3036 Amended Date: 5/22/98

Attorney: Doug Bramhall

Sponsor: _____

SUBJECT: Year 2000 (Y2K) Computer Repair or Replacement Costs Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 2, 1998, STILL APPLIES.

OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to 20% of the costs paid or incurred for the repair or replacement of any computer system related to year 2000 (Y2K) issues. The credit would be limited to a business taxpayer with gross receipts both within and without California not exceeding \$10 million.

SUMMARY OF AMENDMENT

The May 22, 1998, amendments:

- Clarify that sales both within and without California would be considered in computing the gross receipts ceiling of \$10 million above which taxpayers would not be eligible for the credit;
- Require that the taxpayer has taken or is able to take depreciation on the computer, thereby limiting the tax credit to taxpayers who use the computer for business reasons;
- Narrow the definition of "Y2K issues" by providing that upgrades not required to address Y2K issues would not be considered as qualified costs for purposes of this bill; and
- Provide that any credit or deduction otherwise allowable would be reduced by the amount of any credit allowed by this section.

The amendments described above resolve several policy concerns and the implementation concern regarding the use of the term "gross sales" as revised by the prior version of the bill. The remainder of the department's analysis of the

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department/Legislative Director

Date

Johnnie Lou Rosas

7/6/98

bill as amended April 29, 1998, still applies, with a revised revenue estimate provided below. The following policy and implementation considerations identified in the department's analysis of the bill as amended April 29, 1998, still apply and are restated below.

Policy Considerations

Given the broad definition of "Y2K issues," this bill could allow a taxpayer whose computer system is operative but outdated and containing Y2K flaws to receive a 20% credit for a complete system replacement. In such a case, it may be difficult for department staff to distinguish between expenses incurred to upgrade computers or to prevent or resolve Y2K issues. Amendments 3, 4, 10 and 11, provided at the author's request, would clarify the definition of "Y2K issues." Additionally, amendments 1, 2, 6 and 7, requested by the author's office, would remove the requirement that repair services be performed in California and provide that the credit is available for services performed on property located in California.

According to staff at the author's office, it is the intent that the requirement that a taxpayer have gross receipts equal to or less than \$10 million in order to receive a credit under this section would, for taxpayers that are part of a combined group, be calculated on the gross receipts of the entire group. Amendments 8 and 9 have been provided at the request of the author's office.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, but would not significantly impact the department's programs and operations if the implementation consideration described below is resolved.

In recent credits, the Legislature has limited the number of years the unused credit may be carried forward since most credits are exhausted in eight years. This bill permits an unlimited carryover period for any unused credit. At the author's request, amendments 5 and 12 would resolve this consideration by providing an eight-year carryover.

FISCAL IMPACT

Tax Revenue Estimate

It is estimated that this proposal would generate revenue losses as follows:

Estimated Revenue Impact of AB 2458 (As Amended 05/22/98) Taxable/Income Years Beginning In 1998 & 1999 (In \$Millions)				
Fiscal Years	1998/99	1999/00	2000/01	2001/02
Revenue Impact	(39)	(72)	(22)	(7)

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

Tax Revenue Discussion

Revenue losses would depend on expenses associated with computer system modifications and replacements (the bill's language is very broad) and available tax liabilities of qualified business taxpayers. The revenue losses projected for this version of the bill are slightly reduced from losses projected in the department's analysis of the bill as amended April 29, 1998, because the earlier version of the bill would have allowed a deduction in addition to the credit allowed by this bill whereas the May 22, 1998, version would require that any deduction or credit otherwise allowed to a taxpayer attributable to Y2K expenses would be reduced by the amount of any credit allowed.

According to a Federal Reserve projection, the modification and updating of computer systems to solve the year 2000 issue will cost U.S. businesses approximately \$50 billion. Other sources are estimating on the order of \$75 billion. For this bill, it is assumed total qualifying expenses would be closer to \$75 billion. Revenue losses from applied credits (on the order of \$150 million in total) would begin in 1998/99 and would extend beyond the two-year period for qualifying expenses because of carryovers resulting from tax liability constraints and the tentative minimum tax limitation.

Additional assumptions for the order of magnitude impact are as follows:

- Only businesses would qualify for the credit and the \$10 million gross receipts limitation would be based on receipts of the combined group in cases of unitary affiliates.
- California Y2K expenditures represent 15% of the nation (\$75 billion x 15% = \$11.25 billion) of which 85% will be incurred by corporations.
- Of this total, firms with less than \$10 million in annual gross receipts will make 5% of expenditures by corporations and 15% by other businesses. This is based on available gross receipts data on corporate returns for 1996.
- It was assumed that one-fourth of the total impact would occur in the first fiscal year, one-half in the second year, and the balance over the following two years.

Analyst Colin Stevens
Telephone # 845-3036
Attorney Doug Bramhall

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2458
As Amended May 22, 1998

AMENDMENT 1

On page 2, line 3, after "(a)" insert:

(1)

AMENDMENT 2

On page 2, amend lines 7-10 as follows:

of the costs paid or incurred ~~in California~~ by the taxpayer for the evaluation, assessment, repair or replacement of any computer system, or any portion thereof, component, or software owned or operated by the taxpayer and located within this state in order to prevent, or otherwise resolve, Y2K issues, as defined in subdivision (c).

(2) In any case where the computer system, component or software, or any portion thereof, is partially located within this state and partially located without this state, the taxpayer shall be required to use a reasonable method of allocating the total costs paid or incurred to prevent, or otherwise resolve, the Y2K issues. For this purpose, a reasonable method of allocation would include a method whereby costs are allocated based upon the relative fair market values of the property located within this state and the property located without this state.

AMENDMENT 3

On page 2, line 23, strike "or component" and insert:

component or software

AMENDMENT 4

On page 2, strike lines 26-33 and insert:

(c) "Y2K issues" means any expected or actual computer system, component or software complications which will prevent the computer system, component or software from accurately processing, calculating, comparing, or sequencing date or time data that may occur as a result of the year change from 1999 to 2000. These complications include problems associated with the common programming

practice of using a two-digit field to represent a year, resulting in an ambiguous interpretation of the term "00"; the failure to recognize the year 2000 as a leap year, the use of algorithms that use the year "99" or "00" as a flag for another function; or the use of applications, components, or software, that is date sensitive.

AMENDMENT 5

On page 3, amend lines 5-7 as follows:

reduce the "net tax" in the ~~following year, and succeeding eight years~~ if necessary, or until the credit has been exhausted, whichever occurs first.

AMENDMENT 6

On page 3, line 13, after "(a)" insert:

(1)

AMENDMENT 7

On page 3, amend lines 17-20 as follows:

costs paid or incurred ~~in California~~ by the taxpayer for the evaluation, assessment, repair or replacement of any computer system, or any portion thereof, component, or software owned or operated by the taxpayer and located within this state in order to prevent, or otherwise resolve, Y2K issues, as defined in subdivision (c).

(2) In any case where the computer system, component or software, or any portion thereof, is partially located within this state and partially located without this state, the taxpayer shall be required to use a reasonable method of allocating the total costs paid or incurred to prevent, or otherwise resolve, the Y2K issues. For this purpose, a reasonable method of allocation would include a method whereby costs are allocated based upon the relative fair market values of the property located within this state and the property located without this state.

AMENDMENT 8

On page 3, strike lines line 21 and 22 and insert:

(b)(1) If the taxpayer is not a member of a commonly controlled group as defined in Section 25105, the credit provided by this section shall not be available to that taxpayer for any

AMENDMENT 9

On page 3, after line 25, insert:

(2) If a taxpayer is a member of a commonly controlled group as defined in Section 25105, the credit shall not be available to any member of the commonly controlled group for any income year for which the commonly controlled group had gross receipts from all sources, both within and without California, exceeding ten million dollars (\$10,000,000).

@@@ Legislative Counsel, please renumber remaining paragraphs as necessary.

AMENDMENT 10

On page 3, line 33, strike "or component" and insert:

component or software

AMENDMENT 11

Strike from page 3, line 36 to page 4, line 3 and

insert:

(c) "Y2K issues" means any expected or actual computer system, component or software complications which will prevent the computer system, component or software from accurately processing, calculating, comparing, or sequencing date or time data that may occur as a result of the year change from 1999 to 2000. These complications include problems associated with the common programming practice of using a two-digit field to represent a year, resulting in an ambiguous interpretation of the term "00"; the failure to recognize the year 2000 as a leap year, the use of algorithms that use the year "99" or "00" as a flag for another function; or the use of applications, components, or software, that is date sensitive.

AMENDMENT 12

On page 4, amend lines 12-13 as follows:

reduce the "tax" in the ~~following year, and succeeding eight years~~ if necessary, or until the credit has been exhausted, whichever occurs first.